

Office of Chief Counsel  
Internal Revenue Service  
**memorandum**  
CC:NER:MAN:TL-N-3439-99  
JDPappas

date:

to: District Director, Manhattan District  
Attn. Robin Millman, Reviewer  
E:QMS:A

from: District Counsel, Manhattan CC:NER:MAN

subject: [REDACTED]

I.R.C. §6402(b) credit elect issue

UIL Number: 6402.01-02

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We have been asked for assistance in determining when deficiency interest runs in the context of an election to have a refund applied to the subsequent year's estimated tax payment. Our advice relies on facts presented by Robin Millman of the Quality Measurement Staff. The advice rendered in this memorandum is conditioned on the accuracy of the facts provided to us.

**ISSUE:**

Whether underpayment interest begins to accrue on any portion of [REDACTED] (" [REDACTED] ") income tax deficiencies for the [REDACTED], [REDACTED], and [REDACTED] tax years on March 15, [REDACTED], March 15, [REDACTED], and March 15, [REDACTED], respectively.

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FACTS:

On September 15, [REDACTED], [REDACTED] filed its Form 1120 (U.S. Corporation Income Tax Return) for [REDACTED] (extended from a March 15, [REDACTED] due date). On its [REDACTED] Form 1120, [REDACTED] reported an overpayment of \$[REDACTED], which [REDACTED] elected to have credited against its liability for estimated tax for [REDACTED]. However, [REDACTED] did not designate to which installment of estimated tax payments for [REDACTED] the overpayment was to be applied. Thus, pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, the Service credited the overpayment against [REDACTED]'s estimated tax for [REDACTED] as of April 15, [REDACTED], the due date of [REDACTED]'s first installment of estimated tax for [REDACTED]. See also, *Avon Products v. United States*, 588 F.2d 342 (2<sup>nd</sup> Cir. 1978). [REDACTED] estimated its tax payment for tax year [REDACTED] on Form 2220 as follows:

Installment	Due Date	Amount Due	Amount Deposited <sup>1</sup>
1 <sup>st</sup>	[REDACTED]	\$[REDACTED]	\$[REDACTED]
2 <sup>nd</sup>	[REDACTED]	\$[REDACTED]	
3 <sup>rd</sup>	[REDACTED]	\$[REDACTED]	
4 <sup>th</sup>	[REDACTED]	\$[REDACTED]	\$[REDACTED]

As a result of an examination of [REDACTED]'s tax year [REDACTED], the Service assessed a tax deficiency of \$[REDACTED] and corresponding interest of \$[REDACTED]. [REDACTED] paid the tax assessment and interest.

On [REDACTED], [REDACTED] timely filed Form 843 (Claim for Refund and Request for Abatement), requesting that the Service recompute the interest assessed on the [REDACTED] additional assessment. [REDACTED] requests that said interest begin to accrue on the dates prescribed by the holdings in *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996) and *Sequa Corporation v. United States*, 97-1 USTC ¶ 50,317 (S.D.N.Y. 1996). [REDACTED] contends that all estimated tax liabilities were paid from funds other than the credit elect amount. [REDACTED] further contends that interest should begin to accrue on March 15, [REDACTED] (the due date of the [REDACTED] tax return) on the deficiency up to \$[REDACTED], the amount of the credit elect. [REDACTED] agrees that the Service properly accrued interest on the deficiency in excess of the credit elect amount

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<sup>1</sup>Excess payments to an installment were applied to the next payment due date.

beginning on March 15, [REDACTED] (the unextended due date of the [REDACTED] tax return).

[REDACTED]

On September 15, [REDACTED], [REDACTED] filed its Form 1120 (U.S. Corporation Income Tax Return) for [REDACTED] (extended from a March 15, [REDACTED] due date). On its [REDACTED] Form 1120, [REDACTED] reported an overpayment of \$[REDACTED], which [REDACTED] elected to have credited against its liability for estimated tax for [REDACTED]. However, [REDACTED] did not designate to which installment of estimated tax payments for [REDACTED] the overpayment was to be applied. Thus, pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, the Service credited the overpayment against [REDACTED]'s estimated tax for [REDACTED] as of April 15, [REDACTED], the due date of [REDACTED]'s first installment of estimated tax for [REDACTED]. See also, *Avon Products v. United States*, 588 F.2d 342 (2<sup>nd</sup> Cir. 1978). [REDACTED] estimates its tax payment for tax year [REDACTED] on Form 2220 as follows:

Installment	Due Date	Amount Due	Amount Deposited <sup>2</sup>	Credit Elect Needed	Available Credit Elect
1 <sup>st</sup>	[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	
2 <sup>nd</sup>	[REDACTED]	\$ [REDACTED]	\$ [REDACTED]	\$ [REDACTED]	
3 <sup>rd</sup>	[REDACTED]	\$ [REDACTED]		\$ [REDACTED]	\$ [REDACTED]
4 <sup>th</sup>	[REDACTED]	\$ [REDACTED]		\$ [REDACTED]	\$ [REDACTED]

As a result of an examination of [REDACTED]'s tax year [REDACTED], the Service assessed a tax deficiency of \$[REDACTED] and corresponding interest of \$[REDACTED]. [REDACTED] paid the additional tax assessment and interest.

On [REDACTED], [REDACTED] timely filed Form 843 (Claim for Refund and Request for Abatement), requesting that the Service recompute the interest assessed on the [REDACTED] additional assessment. [REDACTED] requests that said interest begin to accrue on the dates prescribed by the holdings in *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996) and *Sequa Corporation v. United States*, 97-1 USTC ¶ 50,317 (S.D.N.Y. 1996). [REDACTED] contends that it needed only \$[REDACTED] of the credit elect to be applied to the 4<sup>th</sup> estimated tax installment to avoid the addition to tax for failure to pay estimated tax under I.R.C. § 6655. [REDACTED] further contends that interest should begin to accrue on March 15, [REDACTED] (the due date of the [REDACTED] tax return) on the entire tax deficiency of \$[REDACTED].

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<sup>2</sup>Excess payments to an installment were applied to the next payment due date.

On September 15, [REDACTED] filed its Form 1120 (U.S. Corporation Income Tax Return) for [REDACTED] (extended from a March 15, [REDACTED] due date). On its [REDACTED] Form 1120, [REDACTED] reported an overpayment of \$[REDACTED], which [REDACTED] elected to have credited against its liability for estimated tax for [REDACTED]. However, [REDACTED] did not designate to which installment of estimated tax payments for [REDACTED] the overpayment was to be applied. Thus, pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, the Service credited the overpayment against [REDACTED]'s estimated tax for [REDACTED] as of April 15, [REDACTED], the due date of [REDACTED]'s first installment of estimated tax for [REDACTED]. See also, *Avon Products v. United States*, 588 F.2d 342 (2<sup>nd</sup> Cir. 1978). [REDACTED] estimates its tax payment for tax year [REDACTED] on Form 2220 as follows:

Installment	Due Date	Amount Due	Amount Deposited <sup>3</sup>
1 <sup>st</sup>	[REDACTED]	\$ [REDACTED]	\$ [REDACTED]
2 <sup>nd</sup>	[REDACTED]	\$ [REDACTED]	\$ [REDACTED]
3 <sup>rd</sup>	[REDACTED]	\$ [REDACTED]	\$ [REDACTED]
4 <sup>th</sup>	[REDACTED]	\$ [REDACTED]	\$ [REDACTED]

As a result of an examination of [REDACTED]'s tax year [REDACTED], the Service assessed a tax deficiency of \$[REDACTED] and corresponding interest of \$[REDACTED]. [REDACTED] paid the additional tax assessment and interest.

On [REDACTED], [REDACTED] filed Form 843 (Claim for Refund and Request for Abatement), requesting that the Service recompute the interest assessed on the [REDACTED] additional tax deficiency. [REDACTED] requests that said interest begin to accrue on the dates prescribed by the holdings in *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996) and *Sequa Corporation v. United States*, 97-1 USTC ¶ 50,317 (S.D.N.Y. 1996). [REDACTED] contends that all estimated tax liabilities were paid from funds other than the credit elect. [REDACTED] further contends that interest should begin to accrue on March 15, [REDACTED] (the due date of the [REDACTED] tax return) on the deficiency up to \$[REDACTED], the amount of the credit elect. [REDACTED] agrees that the Service properly accrued interest on the deficiency in excess of the credit elect amount beginning on March 15, [REDACTED] (the unextended due date of the [REDACTED] tax return).

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<sup>3</sup>Excess payments to an installment were applied to the next payment due date.

## LAW AND ANALYSIS:

In general, the government is entitled to interest on a deficiency in tax for the period that the tax was due and unpaid. I.R.C. § 6601(a); *Avon Products v. United States*, 588 F.2d 342 (2d Cir. 1978). If a deficiency in tax is determined after the taxpayer elected to credit a return overpayment against its estimated tax liability for the next succeeding year, interest will begin to accrue on the amount of the deficiency equal to the amount of the return overpayment as of the effective date of the credit elect. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also, Rev. Rul. 88-98, 1988-2 C.B. 356. Section 413 of the Tax Reform Act of 1984 provides that overpayments of tax will be credited against the estimated income tax for the next succeeding year with full regard to Revenue Ruling 77-475, 1977-2 C.B. 476.<sup>4</sup> Pub. L. No. 98-369, 98 Stat. 494. Revenue Ruling 77-475 provides:

[i]f an overpayment of income tax for a taxable year occurs on or before the due date of the first installment of estimated tax for the succeeding taxable year, the overpayment is available for credit against any installment of estimated tax for such succeeding taxable year and will be credited in accordance with the taxpayer's election.

1977-2 C.B. at 476 (emphasis added). Accordingly, interest on the deficiency in the prior year begins to accrue on the due date of the installment of estimated tax for the succeeding taxable year against which the overpayment was credited in accordance with the taxpayer's designation. H.R. Rep. No. 98-432 (Part I), 98th Cong., 1st Sess. 190 (Oct. 21, 1983); see also Rev. Rul. 88-98, 1988-2 C.B. 356. However, the deficiency only becomes both due and unpaid, and thus triggers the running of interest on that deficiency, when the overpayment balance, after the application to the succeeding tax year's estimated taxes, is less than the deficiency for the overpayment year.

Pursuant to Revenue Ruling 84-58, 1984-1 C.B. 254, which modified Revenue Ruling 77-475, the Service generally was crediting a reported overpayment of tax against the taxpayer's first installment of estimated income tax for the succeeding tax year unless the taxpayer attached a statement to its return that

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<sup>4</sup> In 1983, the Service revoked Revenue Ruling 77-475. Rev. Rul. 83-111, 1983-2 C.B. 245. However, in response to tremendous public criticism and expected Congressional action, the Service promulgated Revenue Ruling 84-58, 1984-1 C.B. 254, which reinstated and modified Revenue Ruling 77-475 on March 30, 1984.

designated otherwise. However, in *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996), the Court of Federal Claims concluded that the assumption behind the default rule in Revenue Ruling 84-58 was that the taxpayer had underpaid its first installment of estimated tax for the succeeding tax year. Thus, a return overpayment will not be deemed to be credited for interest purposes to an installment of estimated tax due prior to the filing of the prior year's return if the taxpayer did not designate the particular installment of estimated tax against which to apply the return overpayment and the installments of estimated tax due prior to the filing of the prior year's return were fully paid without the application of the return overpayment. *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996). On August 4, 1997, the Service acquiesced in the *May Department Stores* decision. *May Department Stores Co. v. United States*, AOD CC-1997-008.<sup>5</sup>

In light of the *May Department Stores* decision, the Service has reconsidered the manner in which interest on a subsequently determined deficiency is computed under I.R.C. § 6601(a) when the taxpayer makes an election to apply an overpayment to the succeeding year's estimated taxes. AOD CC-1997-008. When a taxpayer elects to apply an overpayment to the succeeding year's estimated taxes, the overpayment is applied to unpaid installments of estimated tax due on or after the date(s) the overpayment arose, in the order in which they are required to be paid to avoid an addition to tax for failure to pay estimated tax under I.R.C. § 6655 with respect to such year.

The date the overpayment becomes a payment on account of the succeeding year's estimated tax determines the date the prior year's tax became unpaid for purposes of I.R.C. § 6601(a). Prior

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<sup>5</sup> The *May Department Stores* action on decision provides that,

for deficiency interest purposes, where a taxpayer does not initially designate a reported overpayment to satisfy a particular installment [of estimated tax] for the following year, and crediting of the return overpayment is not necessary to fully pay an installment of estimated tax due prior to the filing of the prior year's return, the reported overpayment will not be deemed to be credited to an installment of estimated tax due prior to the filing of the prior year's return.

*May Department Stores Co. v. United States*, AOD CC-1997-0 (Aug. 4, 1997).

to that date the government has had the use of the funds with respect to the prior year's tax, and no interest is payable on the overpayment that is the subject of the taxpayer's election. See I.R.C. § 6402(b); Treasury Reg. § 301.6402-3(a)(5) and § 301.6611-1(h)(2)(vii). Interest should be charged from the point the prior year's tax is both due and unpaid. *May Department Stores Co. v. United States*, 36 Fed. Cl. 680 (1996), acq. AOD CC-1997-008 (Aug. 4, 1997); *Avon Products, Inc. v. United States*, 588 F.2d 342 (2d Cir. 1978); Rev. Rul. 88-98, 1988-2 C.B. 356. Revenue Ruling 84-58 requires the taxpayer to attach a statement to its return, designating the installment of estimated tax against which the overpayment should be applied. However, we now think that a taxpayer may make a retroactive designation if it made the election to credit the return overpayment on the original return without designating a specific installment and the period of limitations for filing a refund claim has not expired.

In *Sequa Corporation v. United States*, 97-1 USTC ¶ 50,317 (S.D.N.Y. 1996), summary judgment granted by, dismissed by, 99-1 USTC ¶ 50,379 (S.D.N.Y. 1998), the taxpayer had elected to apply its 1990 overpayment to its 1991 estimated tax payments. Subsequently, the taxpayer filed its 1991 tax return showing that the taxpayer had made sufficient estimated tax payments (excluding the overpayment) to satisfy the subsequent year tax liability. Based on the facts before it, the Court opined that the interest on a subsequent tax assessment, up to the amount of the overpayment, begins to accrue on the due date of the subsequent year tax return. The Court reasoned that the overpayment was not "effective" as an estimated tax payment for the subsequent year and that the Service never lost the "use of the money." *Id.*

Where the overpayment is not needed to satisfy any installment of estimated tax in the succeeding year, the overpayment would be treated as a payment of the succeeding year's income tax. Section 6513(d) provides that if any overpayment of income tax is, in accordance with I.R.C. § 6402(b), claimed as a credit against estimated tax for the succeeding tax year, such amount shall be considered as a payment of income tax for the succeeding taxable year (whether or not claimed as a credit in the return of estimated tax for such succeeding taxable year) and no claim for credit or refund of such overpayment shall be allowed for the taxable year in which the overpayment arises. See also I.R.C. § 6513(a) which provides that a payment of income tax made before the date prescribed for payment of the tax is considered paid on that date. The date prescribed for payment of tax is the time fixed for filing the return (determined without regard to any extension of time for filing the return). I.R.C. § 6151. Further, it is

on this date that the overpayment is treated as a payment for purposes of computing interest on any overpayment of income taxes with respect to the succeeding year under I.R.C. § 6611(a) and (d). Thus, we conclude that the statute requires that an overpayment which the taxpayer elects to credit against estimated tax for the succeeding year must be treated as a payment against the next year's tax liability with an effective date no later than the due date of the next year's return.

With respect to [REDACTED], [REDACTED] had an overpayment for its [REDACTED] tax year and made sufficient estimated tax payments for [REDACTED], excluding its [REDACTED] overpayment, to avoid the failure to pay estimated tax penalty under I.R.C. § 6655. To the extent the deficiency is greater than the overpayment, interest on that amount ( $\$[REDACTED] - \$[REDACTED] = \$[REDACTED]$ ) will accrue from the unextended due date of the [REDACTED] return, i.e., March 15, [REDACTED]. As of the due date of the next year's return, March 15, [REDACTED], the Service no longer had use of the overpayment credit for [REDACTED] since it is considered a payment of tax effective on the due date of the next year's return. It is at this point that deficiency interest will run on the entire deficiency ( $\$[REDACTED]$ ).

For [REDACTED], [REDACTED] had an overpayment of  $\$[REDACTED]$  and  $\$[REDACTED]$  of it was needed to be applied to the fourth estimated tax installment payment for tax year [REDACTED] to avoid the failure to pay estimated tax penalty under I.R.C. § 6655. The difference,  $\$[REDACTED]$  ( $\$[REDACTED] - \$[REDACTED]$ ), is greater than the tax deficiency assessment for [REDACTED] in the amount of  $\$[REDACTED]$ . Thus the deficiency did not become both due and unpaid at this time. Accordingly, interest will begin to accrue on the tax deficiency on March 15, [REDACTED], the due date of the subsequent year tax return, since it is considered a payment of tax effective on the due date of the next year's return.

[REDACTED]'s [REDACTED] tax year also resulted in an overpayment and like [REDACTED], it made sufficient estimated tax payments for the subsequent year, excluding its [REDACTED] overpayment, to avoid the failure to pay estimated tax penalty under I.R.C. § 6655. To the extent the deficiency is greater than the overpayment, interest on that amount ( $\$[REDACTED] - \$[REDACTED] = \$[REDACTED]$ ) will accrue from the unextended due date of the [REDACTED] return, i.e., March 15, [REDACTED]. As of the due date of the next year's return, March 15, [REDACTED], the Service no longer has use of the overpayment credit for [REDACTED] since it is considered a payment of tax effective on the due date of the next year's return. It is at this point that deficiency interest will run on the entire deficiency ( $\$[REDACTED]$ ).

**CONCLUSION:**



Based on the foregoing, we recommend that you allow the refund of interest requested by the taxpayer for each of the years and accrue interest as follows:

<u>Tax Year</u>	<u>Date Interest Begins Accruing</u>	<u>Deficiency</u>
██████	████████████████████	\$ ██████████
	████████████████████	\$ ██████████
██████	████████████████████	\$ ██████████
██████	████████████████████	\$ ██████████ <sup>6</sup>
	████████████████████	\$ ██████████

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<sup>6</sup>The information presented by you indicates interest accrues on March 22, ██████ and June 10, ██████ on \$██████, and \$██████ of the deficiency, respectively. Based on the facts presented to us for our consideration, we believe that the interest on the deficiency in excess of the overpayment (\$██████, which includes the \$██████ and \$██████) should begin to accrue on March 15, ██████ under I.R.C. § 6601(a).

We remind you that this is proposed advice, which is subject to National Office post review. We will contact you within two weeks of the date of this memorandum to discuss the National Office's comments, if any, about this proposed advice. Should you have any questions regarding this matter, please contact Jeannette D. Pappas or Oleida Mendiburt of our office at (212) 264-1595, Ext. 243 or Ext. 214, respectively.

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